

VISIT...

LANZAROTE
Caliente.COM

Complete instructions on how to Pack and Ship: **almost anything**

Step 1: Drop it off at FedEx Kinko's.

Find a Location 

Make it. Print it. Pack it. Ship it.





Inc.
Inc.com

What's Your Company Worth Now?

Knowledge is power, and knowledge of your company's value is the ultimate power tool.
Here's what you need to calculate your own magic number.

From: [Inc, July 2003](#) | By: Randall Lane

Meet me in the parking lot behind Luke's Hamburgers in 15 minutes." I was sitting in my hotel room at 10 p.m. when the phone rang and those orders were given. This is not the kind of offer someone generally considers from a stranger in a city 2,000 miles from home. But I was a cub reporter and the caller was one of the richest men in Texas, so late-night Luke's it was.

My new acquaintance was Jerry J. Moore. A high school dropout, Moore had made his fortune in shopping malls and had what experts considered the best car collection in the country -- and I saw evidence of both facts over the next two hours as he took me on a tour of his real estate holdings and then his house. It was an 18th-century French chateau, brought over stone by stone, and while we were there I sat in LBJ's old limo and gazed at shiny Duesenberg after shiny Duesenberg. Dressed in a polyester golf shirt, the squat Moore struck an unassuming figure (a neighbor once mistook him for a gardener and paid him to mow his lawn) but he was unquestionably rich, and the purpose of this midnight excursion was to prove to me just how rich he was. My job, as a reporter for another magazine, was to calculate Jimmy's net worth to the penny; his goal was to inflate it as much as possible.

I knew Moore was trying to play me -- the more valuable his company appeared, the better terms he could get from banks -- but I understood. The stakes were high. What are you worth? They might be the four most gauche words in the English language, but for any businessperson, whether a shopping mall magnate or shoe store owner, they might also be the most important.

A business's success is ultimately measured by a business's value. Public companies, with a quick glimpse of their market capitalization, benefit from a daily evaluation on this basis. But since most private business owners never calculate their business's worth until forced to do so, they lack similar insight. Knowledge really is power and, as Jerry J. Moore knew instinctively, knowledge of net worth is a tool. Knowing your net worth as a private business owner provides a useful snapshot of where your company stands, what options it has, and how it can improve long-term.

Think of net worth valuation for your company as a reality check. In calm times, you can view self-assessment as a luxury, but not right now, with business markets in historic flux. For private companies, valuations peaked sometime around January 1999, according to Business Valuation Resources, a Portland, Oreg.-based company that tracks private company sale transactions. Unfortunately, since the decline began in 1999, the business cycle has not yet rebounded.

Michael Gorun saw the signs early on. Values have been falling, on average, 25% a year since 1999 and Gorun, who founded CarSmart, one of a handful of websites that gained traction selling new and used automobiles, was particularly vulnerable. By 2000, he knew that he needed to do something quickly, but he wasn't sure of the correct route. Montgomery Securities and later Banc of America Securities both saw Gorun's firm as an attractive IPO or acquisition candidate and were suggesting his company was worth

between \$80 million and \$200 million. "It was like throwing a dart at a board," says Gorun. Such a head-spinning valuation could have given him a false sense of confidence while the markets crashed around him.

But, lacking faith in those with an incentive to give him an unrealistically high valuation, Gorun hired an independent valuator, American Business Appraisers, based in Danville, Calif. By paying for his own research, his appraiser gave him a number that was disappointing -- in the \$30 million range -- compared with the giddy IPO figure bandied about by his bankers. But it was a number he trusted, one that more accurately reflected the market. Gorun began shopping CarSmart with a far more realistic attitude and eventually sold to Autobytel in February 2001 for \$33 million. Since \$28 million of that came in fast-falling stock, Gorun didn't do as well as he'd hoped. But he also feels fortunate to have cashed out at all. Had he believed the \$200 million valuation was accurate, he may not have.

Of course, it's not just the dot-coms that have seen their valuations tumble in recent years. "I can't think of any industry where valuations are rising," says Scott Murphy, senior vice president at New Orleans-based Advantage Capital Partners. For most, the challenge has been to minimize the damage. Fields like finance and insurance are down just a hair, thanks largely to low interest rates, which have kept the cost of their raw material -- cash -- historically low. Business services, meanwhile, have been crushed, down about 50% from the peak. "In terms of transactions and value," says Brooks Dexter, senior managing director of USBX Advisory Services in Santa Monica, Calif., "it looks like 1995." This valuation erosion plays no geographic favorites -- multiples, usually higher on both coasts in good times and bad, have fallen uniformly.

But the downturn has hit smaller companies harder. In 2002, according to a report by Los Angeles-based investment bank Houlihan Lokey Howard & Zukin, the average price to EBITDA multiple of companies with greater than \$1 billion in sales was 9.5; for companies of less than \$100 million, it was 6.5. "As one of the grizzled bankers who trained me put it," says Justin Abelow, senior vice president at Houlihan Lokey, "whales hold their breath longer than minnows." Even successful start-ups can be in the vexing position of outlasting their competitors and yet still find themselves worth less than they were a few years ago. "Small investors are astonished by the fact that their company has done well but still gone backward in valuation," says Murphy, of Advantage Capital. "That's a tricky place."

Is there any good news here? Well, yes. A close study of the numbers indicates that valuations seem to have bottomed out. The deal figures in 2003 have held up to 2002. More telling, look at the cash percentages in these acquisitions. According to a recent report by JPMorgan, which crunched numbers from Thomson Financial, the average acquisition in 1998 was financed 68% with stock. By 2000, it was 57%; in 2001, 45%; and last year, excluding one deal, the Pfizer-Pharmacia merger, that figure fell all the way to 24% -- the smallest margin in a generation. Cheap stock fueled the valuation run-up: As the cash portion has risen, prices have dropped. But with cash now constituting three-quarters of the typical deal, it's a good sign that we've hit a turning point.

Given this new landscape, taking stock of your company, as Michael Gorun did, can offer a window into potential opportunities for improving your valuation.

Over the 23 years Terry MacRae has owned San Francisco-based Hornblower Yachts, it's hardly been smooth sailing. He's gone through virtually every type of small-business transaction: subordinated debt offerings, equity-leveraged acquisitions, partner buyouts, division selloffs. But in the end, he's thrived. Hornblower, which handles charters and dinner cruises along the California coast and has an affiliate that manages casino boats in the Midwest and Bahamas, owns 25 boats and boasts revenue of \$30 million, along with a healthy profit margin.

His secret weapon? For the past 15 years, he's kept an annual tally of his company's worth, hiring professional appraisers when plans are afoot, and updating their models in more stable periods. "It keeps you out of trouble," he says. "It keeps you from being out there, believing what isn't true. And it gives you a better sense for using what resources are there. Leverage is a two-edged sword. You need to know

whether you have the equity to support it, so you need to know what the equity is."

MacRae isn't bashful about his wealth. Like Jerry J. Moore, he shows it to his lenders to secure credit lines, and he shares it with his spouse to help her manage the family budget. And he has valued his own business using three different techniques -- by assets, earnings, and cash flow -- for comparison. "You frequently make decisions that are not short-term in nature," says MacRae, "and it's helpful to be able to rely on an appraisal process to make better long-term decisions."

For all-too-many private business owners who aren't looking to sell or raise new equity, valuation questions tend to come in three instances: first, if a partner or stockholder leaves and either demands a fair-market buyout or invokes a buy-sell clause. Second, if a principal is going through a divorce. And, third, because of death or estate planning, when the taxman descends to see if the government deserves a cut and the heirs pull out calculators to add up what they get. All these scenarios have one thing in common: They're a mandatory response to outside circumstances, designed to come up with a number that solves a dispute.

Such business appraisals, reacting to external events, prove less a tool than a mop. Ponder for a minute a case approaching the court system on the West Coast. It involves a closely held construction company that has a buy-sell agreement among its partners -- nothing unusual there, except that the price hadn't been updated in about a decade, according to an accountant familiar with the situation. When one of the partners died recently, the company conducted a belated valuation. The surviving partners found a windfall -- they can buy out the late partner's estate for a fraction of its true worth. But they also bought a lawsuit filed by the surviving relatives.

Proactive knowledge, meanwhile, can prevent headaches. And when it's time to sell, it yields money. How much? That depends, but for San Jose-based Teleparts, which started as a semiconductor parts firm, the figure was about \$250,000. Teleparts' business soared with the invention of wafer cleaning used in the fabrication of semiconductors. Sales shot past \$20 million, and the company went public in 1995. The original parts business was still chugging along, however, with about \$600,000 in revenues.

An obvious candidate for sale, the company had to figure out how to value an entity that wasn't a standalone. "When you get into the harder values to assign, the goodwill and esoteric, when you get into the fuzzy area, we don't understand those numbers," says Patrick O'Connor, the former chief financial officer of parent company OnTrak Systems. "As a CFO, we understand the inventory and the receivables and fixed earnings." So it hired Robert Laversin at American Business Appraisers.

Privately, O'Connor and his team had previously decided that about a half million dollar price for the division would be a big win. When appraiser Laversin came back with a valuation at \$775,000, however, the goals changed. Teleparts wound up selling for that exact price. "I used his report as the value," he says. "It was fair and independent." That seal of approval was worth a good \$250,000 to Teleparts -- quite a return on the \$15,000 investment for the valuation. "It was a very good deal," says O'Connor. "We were very happy."

Still, O'Connor's process was somewhat akin to slapping a new coat of paint on a house for sale. At least he got the valuation before he'd settled on a sale price, but it would have been more proactive and effective to secure a valuation several years before a potential sale. Joe Maskrey, former CEO of InfoGraphic Systems, a \$20 million annual revenue electronic security equipment manufacturer in Garden Grove, Calif., hired USBX in January 2001 -- a full 22 months before he sold his company to General Electric this past November. The USBX valuation, which came in at \$18 million, set off a process that led to the eventual sale. "It gave an idea of what would be a really good scenario for us to go for as an exit strategy," says Maskrey, now president of the new company, GE Interlogix, InfoGraphics. Under its current business model, Maskrey's company would be valued by a multiple of earnings. But by adopting a somewhat different business strategy, geared more toward growth, Maskrey could put himself in a category of companies valued by a multiple of sales. Thus armed with a plan, Maskrey positioned InfoGraphic as a strategic rollup, and sold for a price Maskrey characterizes as "a lot more" than the \$18

million 2001 appraisal.

For Linda Graebner, who last year sold Tilia Inc., a San Francisco-based vacuum-packaging company (manufacturer of the FoodSaver), valuation knowledge proved much more than a part of her exit strategy; it was also a tool for rebirth. When she took over as CEO of Tilia in 1993, it had less than \$10 million in revenue and was basically insolvent. The best recapitalization route seemed to be a combination of Chapter 11 and new investment. But how do you value a company in bankruptcy? Graebner hired an independent appraiser to develop a rationale, in this case a discounted cash flow model based on anticipated future earnings.

The model worked, and Graebner grasped the value of valuation. As Tilia grew, Graebner had her finance department conduct regular internal valuations so that company stock-option packages could be priced correctly. By the late '90s, Tilia had \$80 million in revenue and Graebner wanted to restructure the company into subsidiaries. She was especially curious about the value of the intellectual property Tilia had accumulated, and how the subsidiaries would charge licensing fees to each other for the IP. Again, she called in a valuation expert, in this case a consulting arm of the now-defunct accounting firm Arthur Andersen. Andersen valued the company and "it reinforced how valuable our intellectual property was," says Graebner.

Later, the company decided to investigate a sale in 2000. Graebner ordered another valuation, this one focused strictly on market value for Tilia, which now had revenue close to \$150 million. The M&A market was tanking at the time -- the company's likely range of pay-out multiples, Tilia discovered, had gone from high-end estimates of eight times EBITDA to some as low as three and a half. Tilia's EBITDA for 2000 was \$25.2 million, yielding an approximate value for the company of \$140 million to \$150 million, based on a median valuation multiple in the 5.5 to 6 range. Pessimistic that valuations would rebound soon, Graebner accepted a buyout offer last year from Altrista (since renamed Jarden), a New York-based kitchenware maker, for \$160 million. "The valuation told us that was a fair price," says Graebner. "In 1999, that would have been low, but in 2002, that was a fair price."

To really use valuation as a tool to improve your business, figuring out an estimated worth is just a first step. The real key is acting on the knowledge. Danny Karpin runs the kind of family business you almost never sell. A quarter century ago, his father started Metalco Steel & Supply, a Torrance, Calif., distributor that breaks up hot-rolled carbon steel from mills and then resells it in smaller batches. After his dad died 19 years ago, his mother, Shoshana, took over the company and continued to nurture it. When Karpin, now 34, graduated from college 12 years ago, he immediately joined the six-employee firm, which has more than \$5 million in revenue.

Despite having no specific plans to change the business, Karpin ponied up almost \$10,000 in 2001 to hire USBX to perform a soup-to-nuts valuation. "This business has been around 25 years, and grown for the last 10 straight and we felt that we may have exhausted everything we knew how to do to grow," he says.

Karpin says he wasn't disappointed when USBX assessed his company with a figure in the lower range of what he'd hoped. Instead, he viewed it as a reality check. His valuation came in low because his business was strictly a wholesaler, selling standard-length steel section. Companies that provided value-added services in his sector, such as cutting to size or shearing, were priced less like a commodity provider and more like a retailer with a premium. "We've added some services, and I feel that helped us in a slow economy," he says.

While there are plenty of appraisal-for-hire types who, for legal purposes, will justify whatever number you ask them to come up with, the talented business valuator acts like a business consultant, stripping down your business to figure out its value, and leaving a blueprint for making it higher next time.

There are two senior certifications for which you should look when hiring an appraiser, although not every qualified firm will have them. The ASA (American Society of Appraisers) gives out an ASA (Accredited Senior Appraiser), which requires courses, exams, five years of experience, and peer review of reports. The IBA (Institute of Business Appraisers) certifies its CBA (Certified Business Appraiser) in

much the same way. Those looking to really confuse themselves can ask about an ABV (Accredited in Business Valuation) designation from the AICPA (American Institute of Certified Public Accountants), or the lightly regarded CVA (Certified Valuation Analyst) issued by the NACVA (National Association of Certified Valuation Analysts). Strong recommendations from an expert's savvy, satisfied customers is better than any certificate, though.

Appraisal costs vary, of course, but here are some ballpark figures. A bare-bones, quick-and-dirty might run \$4,000. For a full-blown report, running at least 30 pages and involving several days kicking your tires, the bill could come in at \$10,000. Never pay based on a percentage of your company's value. "The bottom line," says David Newton, a top California appraiser, "is that there's no additional work between a well-organized \$10 million company and a \$3 million company." There is less work, however, with reappraisals. Demand a discount if the valuation is more update than original investigation.

Each business has its own blueprint for success, but one key to a high valuation is minimizing risk. To an outside buyer, more risk carries expectations of a higher return -- and thus a lower price. With this criteria in mind, a survey of business appraisers shows that many rules of thumb prove fairly universal in enhancing value. And that starts at the top, with the area over which you have the most control: management. If you're looking for long-term value, owner compensation must be in line with industry peers. If it's out of whack, it both suppresses earnings and raises red flags. A deep management team is also vital, since a business that relies too heavily on one person won't be as valuable.

When evaluating an earnings stream, diversity is critical. Just as having only one key executive creates risk that could suppress value, the same is true of having only one or two key customers. This diversity carries over to product lines and services -- as Metalco's Karpin learned, a broad offering generally makes a business less vulnerable to business cycles.

But don't add customers just for the sake of padding the client list and the sales figures -- as numerous models demonstrate, cash flow is king. Businesses that command a premium maximize profits over sales. "I've seen losing divisions weigh down the value to the buyer," says Mary Ellen Ludeking, an appraiser in Florida. As new customers materialize, formal -- and transferable -- contracts create direct value for potential buyers. Just as with customer diversity, vendor diversity proves important: Overreliance on a single vendor ups the risk quotient and thus impairs value.

Finally, concentrate on the underlying aspects of value, rather than the valuation number itself. Which brings us back to our friend Jerry J. Moore. This was a man obsessed with his net worth, or at least what I considered it to be. He and his accountant spent two hours with me the day after our Luke's Hamburgers meeting, poring over his holdings. He then began calling me every week or two, full of spin. To Moore, the number was an end in itself -- something that would establish his business worth for the world (my figure came in around \$500 million). But Moore missed the fundamental lesson of using net worth as a tool: the actual number is less important than employing it to improve the business. At the very time Moore was courting me, it turns out, he was also searching for an exit strategy. He engaged an investment bank to try to take him public as a REIT, but the market dried up. The next year, he tried the REIT route again, but once again there were no takers. Morgan Stanley, however, had a real estate arm, and wound up buying a controlling interest in Moore's properties for a figure that was made public at \$400 million, but that one source told *The Wall Street Journal* was closer to \$100 million once assumed debt was factored in. Last year, he put his chateau up for sale, complete with the 26-car underground air-conditioned garage. Price tag: \$18 million. No tears for Moore, of course, but I've often thought about how much time he spent wooing me, and how if he'd spent that time tending to his business, he might have a few extra Duesenbergs in his collection.

Sidebar: The Do-It-Yourself Appraisal

So what *are* you worth? There's no precise answer, of course. The specific number is less important to you than the general range and the process that gets you there.

If you need a valuation and are asking the question for the first time, many businesses opt for letting an outside appraiser figure out the answer. These reports, which run up to 50 pages, provide the owners with a blueprint that can be tracked afterward. But like most other tasks, it's also possible to do this yourself. Ballpark valuation can be derived from at least six widely used techniques, each involving varying degrees of difficulty and yielding different levels of precision. And, with the information on pages 78 to 79, your P&Ls, and the 10 different industry metrics listed can also give you a good estimate, although it can't tell you whether your business deserves more or less than the typical company in your field.

Book Value: The old classic, with an emphasis on old. The methodology is simple: Take your assets, including cash, physical plant, and receivables, and subtract liabilities and debt. It's a great formula -- if you're a bank or insurance company. But it's pretty poor for everybody else except as a reality check. Adjusted book value, which factors in non-balance sheet items like intellectual property, goodwill, and depreciated assets, works better but still suffers by its simple adherence to asset-based value. "I don't know anyone who's ever done a deal where book values are the way to go," says David Newton, a professor of entrepreneurial finance at Westmont College in Santa Barbara, Calif., who frequently testifies about valuations as an expert witness in litigation, "but I do use it when I get a value in another model and it's way out of line." Perhaps the best thing about a book value appraisal is that it's so simple. Such asset-based appraisal will almost always prove too low, but it gives you a floor to start from.

Liquidation Value: Not as dated as book value but close. The premise is simple: If you had to raise as big a pile of cash today as you could, what could you get for the pieces of your company? Good receivables might fetch 80¢ on the dollar, short-term inventory maybe 60¢. It's basically a snapshot of the fair market value of what you currently hold. A better but still flawed version of this model: replacement cost, as in what would it cost me to get everything I have if I started from scratch. Like book value, the liquidation/replacement models derive from the largely outdated concept that a business is only as good as its hard assets.

Excess Earnings: Think of this technique as a book value concept for the 21st century. It starts with your tangible assets, and then takes the next step by asking what would be a standard return on equity. Any money earned above this amount is considered excess earnings -- an income stream that clearly has value above the core value. Capitalize this stream, add it to the original book value, and you have your figure. Not a bad exercise, but problems exist both because of the way book value itself is calculated and the inexact science of figuring out a proper return-on-equity benchmark. Newton gives an example: A consulting firm that leases all its equipment might have just \$200,000 in assets on its books but earn \$10 million a year, which would give it a return on equity of 5,000% and an excess earnings valuation that is off the charts.

Multiples Models: The favorite of back-of-the-envelope valuers everywhere. Take your earnings or sales, and multiply it by the P/E or P/S multiples of comparable public companies. Better yet, use our table, or similar special industry information for private companies, to get a more accurate valuation multiple. Volatility is the problem here: Are your most recent profits and sales reflective of your long-term prospects -- and ditto for your comparables? For a smaller private company, both profits and sales can prove erratic and often fail to recognize debt and other intangibles properly. The comparable multiples of public companies, meanwhile, might be inflated or deflated by company-specific occurrences such as a new product rollout or management turnover. That said, if the earnings or sales figures are stable, it's a pretty solid technique, albeit one that fails to indicate specific areas to improve upon.

Comparative Value: Every homeowner knows this concept -- a real estate broker demonstrates what similar houses in similar neighborhoods have sold for recently to demonstrate market value. Substitute a business broker, and the same method can work for private companies. Unlike title transfers, which are almost always publicly available, company transaction information is harder to gather. Still, it's out there and if, like the multiples models, the comparable companies are carefully screened, it's a solid barometer.

Discounted Cash Flow: This is a Wall Street favorite, the basis for how many analysts come up with their target ranges. Despite that currently dubious affiliation, it's probably the most respected valuation

technique. It takes the excess earnings concept and reverses it, so that imperfect yardsticks like book value and standard return on equity are removed. The premise here: Rather than assets, a company's value is based on its ability to generate sustainable long-term cash flows. Past performance is less important than a thorough analysis of margins, overhead, debt, tax bracket, long-term obligations, labor and material costs, and sales growth. Using a forecast of future cash flow, you can treat it like an annuity and discount it to present value. R.L.

Randall Lane is a New York-based business writer. Jennifer Reingold is co-author of *Final Accounting* .

Copyright © 2004 Gruner + Jahr USA Publishing. All rights reserved.
Inc.com, 375 Lexington Avenue, New York, NY 10017.